Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

CITY OF NEW ORLEANS,

Petitioner,

v.

UNITED STATES DEPARTMENT OF LABOR,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

The City of New Orleans petitioned for review of a final order of the United States Department of Labor ("USDOL") disallowing certain expenses allegedly incurred pursuant to the Job Training Partnership Act ("JTPA"), 29 U.S.C. § 1501 *et seq.*, and requiring the State of Louisiana, and ultimately the City of New Orleans, to repay those disallowed expenses to the USDOL.

The United States Fifth Circuit Court of Appeals affirmed the Order of the USDOL and concluded that because the Secretary's final decision was based on statutes and regulations in effect at the time the contracts were executed, the USDOL did not violate the petitioner's due process rights. The question presented here is:

May the USDOL retroactively interpret regulations and guidelines concerning contracting and procurement requirements in violation of the petitioner's due process right of notice of prohibited conduct?

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PETITION FOR WRIT OF CERTIORARI

The City of New Orleans respectfully prays that a Writ of Certiorari be issued to review the Judgment and Opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on March 28, 1997, to resolve a conflict between the Fifth Circuit Court of Appeals and this Court on the important issue presented herein.

OPINIONS BELOW

In October 1988 the USDOL Office of Inspector General ("OIG") began an audit of the New Orleans Job Training Partnership Program. On February 6, 1991, the OIG issued its audit report and on January 5, 1994, almost three years following the issuance of the audit report, the USDOL issued a final determination disallowing certain costs connected with fixed-unit-price contracts awarded by the City of New Orleans. An appeal of the Grant Officer's decision was taken and on July 7, 1994, a hearing was held before an Administrative Law Judge ("ALJ").

On October 23, 1995, the ALJ issued his Decision and Order which ruled that the questioned costs were subject to federal debt collection. (*See,* Appendix). The State of Louisiana and petitioners timely filed a Request for Review with the Secretary of Labor, but the Secretary refused to review the case. (*See,* Appendix).

The State of Louisiana timely filed a Petition for Review. The City of New Orleans filed a Motion to Intervene in the Petition for Review, which was granted by the United States Court of Appeals for the Fifth Circuit. On March 28, 1997 the United States Court of Appeals for the Fifth Circuit denied the Petition for Review and affirmed the Secretary's Decision. (*See*, Appendix).

JURISDICTION

Pursuant to Supreme Court Rule 13(1), this Petition for Writ of Certiorari has been filed within (90) ninety days after entry of the Judgment of the United States Court of Appeals for the Fifth Circuit.

The jurisdiction of the Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTES INVOLVED IN THE CASE

29 U.S.C. §1575(a)(1982), provides:

> (1) Recipients shall keep records that are sufficient to permit their preparation of reports required by this chapter and permit the tracing funds to a level of expenditure adequate to insure that the funds have not been spent unlawfully.
>
> (2) Every recipient shall maintain such records and submit such report in such form and containing such information, as the Secretary requires regarding the performance of its programs.

JTPA regulations, 20 C.F.R. §629.35, provides:

> (a) The Governor shall insure that financial systems within the State provide fiscal control and accounting procedures sufficient to (1) permit preparation of required reports; (2) permit the tracing of funds to a level of expenditure adequate to establish that the funds have not been used in violation of the restrictions on the use of such funds; . . .
>
> (b) The Governor shall insure that records shall be maintained of such participant information as may be necessary to develop and measure an achievement performance standard established by the Secretary.

20 C.F.R. §629.38(e)(2), provides:

> (a) Costs which are billed as a single unit charge do not have to be allocated or prorated among the several cost categories but may be charged entirely to training when the agreement:
>
> (i) Is for training;
>
> (ii) Is fixed-unit-price; and
>
> (iii) Stipulates that full payment for the full unit price will be made only upon completion of training by a participant into unsubsidized employment in the occupation trained for and not less than the wage specified in the agreement.

29 U.S.C. §1579(a), provides:

> (A) All rules and regulations shall be published in the federal registry at least (30) thirty days before their effective date.

STATEMENT OF THE CASE

In 1983, the State of Louisiana entered into an agreement with the Secretary of Labor to become a grant recipient under the JTPA. Under this agreement, the State disbursed federal funds to several service delivery areas throughout the State including the City of New Orleans. The service delivery areas solicited grant proposals from service providers and selected sub-grantees to receive the grant funds.

In New Orleans, classroom training programs were generally awarded under fixed-unit-price contracts, which demand successful performance as a prerequisite for payment. The New Orleans Client Center ("NOCC") was awarded JTPA grant funds to conduct employment work shops during program year 1985, and Technical Training Designs, Inc. ("TTD") was awarded JTPA grant funds to provide youth competency training, basic computer skills and remedial education during program years 1986 and 1987. It is uncontroverted that NOCC and TTD successfully performed their obligations under the grant contracts and each was properly paid according to the fixed-unit-price formula.

In 1988, the USDOL initiated an audit of the New Orleans JTPA Program focusing on program years 1986-1987. The USDOL then expanded the audit to cover program years 1985 through 1989. The audit report, issued by the USDOL in 1991, questioned, *inter alia*, the fixed-unit-price contract granted to the NOCC for program year 1985. Unable to resolve objections concerning that fixed-unit-price contract, the USDOL issued an initial determination disallowing the entire unresolved NOCC

debt. The USDOL also disallowed payments made to TTD under the fixed-unit-price contracts governing program years 1986 and 1987.[1] The total disallowed costs by the USDOL was $894,615.

The State of Louisiana appealed this final determination to an ALJ who affirmed the final determination and ordered the State to repay the disallowed costs. The ALJ dismissed the USDOL's conclusion that there was a conflict of interest by NOCC and TTD in violation of the JTPA, but he agreed with the USDOL's conclusion that the NOCC and TTD had failed to maintain accurate and reliable records as required by the JTPA and that New Orleans had violated procurement procedures by failing to determine whether the grant proposals were fair and reasonable.

The State of Louisiana timely appealed to the Secretary of Labor, specifically identifying exceptions to the Decision as required by 29 U.S.C. §1576(b), but the Secretary refused to review the case. Therefore, the decision of the ALJ became the final decision of the Secretary. 29 U.S.C. §1576(b). The State timely filed a Petition for Review pursuant to 29 U.S.C. §1578(a)(1). The City of New Orleans filed a Motion to Intervene in the Petition

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[1] The initial determination disallowed a total of $990,298 in expenses incurred under the fixed-unit-price contract between the City of New Orleans and NOCC and TTD. After considering a response filed by the State of Louisiana that demonstrated that the audit report overstated total payments under the TTD contracts, the USDOL revised its initial determination and reduced the totaled disallowed costs to TTD by $54,460. Likewise, the USDOL subsequently allowed costs of $41,223 under the NOCC contract.

for Review, which was granted by the United States Court of Appeals for the Fifth Circuit. The United States Court of Appeals for the Fifth Circuit denied the Petition for Review filed by the State and the City and affirmed the Secretary's decision. —

REASONS FOR GRANTING THE WRIT

I.

The Fifth Circuit's opinion directly conflicts with this Court's decision in *Bowen*, which prohibits retroactive policy changes, and is contrary to the principles of federalism embodied in the enactment of the JTPA.

BACKGROUND

1. The Legislative Purpose of The JTPA

Congress enacted the JTPA to assist people with serious employment barriers to become productive members of the labor force. 29 U.S.C. §1501, *et seq.* In replacing the Comprehensive Employment and Training Act (CETA) with JTPA, Congress intended to "recognize the role of the state in all federal programs and end the excessive involvement of the federal government." 1982 U.S.A.C.C.A.N. 2637.

In contrast to CETA, the federal government intended to allow greater flexibility and authority for the states in its operation and administration of the JTPA program. 1982 U.S.C.C.A.N. 2636-2638. In recognizing the true principals of "federalism," Congress stated that JTPA requires the "involvement of the private sector in the design and administration of training programs."

1982 U.S.C.C.A.N. 2636-2638. Congress clearly intended JTPA to be a performance-driven system where the Secretary of Labor's most important role is to establish performance standards. *Id.* at 2637, 2639.

2. JTPA Scheme

Under the Job Training Partnership Act, the federal government appropriates funds for the states to provide job training. 29 U.S.C. §1502. The Governor must appoint a State Job Training Coordinating Council to receive this funding. 29 U.S.C. §1532. Based upon recommendations by this Council, the Governor designates Service Delivery Areas (SDAs) to deliver training and employment services. 29 U.S.C. §1511. Private Industry Councils (PICs) are established in each SDA. Most members of the Council must be local representatives of business and industry. 29 U.S.C. §1512. The PICs select service providers, provide policy guidance, formulate job training plans and exercise oversight with respect to the job training activities in the SDA. 29 U.S.C. §§1513-1515, 1517.

To establish a relationship under JTPA and become an eligible grant recipient, federal regulations require that the Governor of a state and the Secretary of the United States Department of Labor execute a Governor/Secretary Agreement. 20 C.F.R. §627.1 (1984). This agreement requires that the federal government grant the state great latitude in establishing rules for the operation of the JTPA program. Congress established that it did not wish to preempt all state or local regulations. To the contrary, "the architecture of JTPA is such that resort to state law is

necessary to round out some of the details of the statutory scheme." *Hernandez-Colon v. Secretary of Labor*, 835 F.2d 958, 963 (1st Cir. 1988).

The Governor/Secretary Agreement reached on August 5, 1983, further mandated that the Secretary of USDOL accept all guidelines, interpretations and definitions adopted by the Governor if they are consistent with the JTPA and its applicable rules and regulations. To further the intent of Congress that states play a larger role in the administration of the JTPA program, federal regulations permit recipients[2] and subrecipients[3] to "administer procurement systems that reflect applicable State and local law, rules and regulations as determined by the Governor." 20 C.F.R. §629.34 (1984).

The federal regulations also established a rule addressing allowable costs under the JTPA. To be allowable under JTPA, the cost must be "necessary and reasonable." Costs are necessary and reasonable when they are consistent "with applicable state and local law, rules or regulations as determined by the Governor." 20 C.F.R. §629.37(a) (1984). The Governor is also required to "issue guidelines on allocable costs for SDA and statewide programs." 20 C.F.R. §629.37(c) (1984). The Governor, therefore, is required to establish guidelines for allowable and unallowable costs where JTPA and federal regulations do not specifically provide guidance.

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[2] A "recipient" is defined as the Governor of a State. 20 C.F.R. §626.4.

[3] A "subrecipient" means any person, organization or other entity which receives funds either directly or indirectly from the Governor.

3. Regulations Regarding Fixed-Unit-Price Contracts In Effect When The City Contracted With NOCC And TTD

JTPA regulations in effect in 1985 through 1987 simply required that all costs incurred by programs be charged in either the training, administration, or participant support cost category. 20 C.F.R. §629.38(a). A maximum of 15% could be charged to the administration cost category. 29 U.S.C. §1518. The JTPA regulations, however, granted to SDAs a certain amount of flexibility in contracting for training of JTPA participants.

However, under certain circumstances costs billed under a contract as a single unit, such as fixed-unit-price contracts, may be charged entirely to the training category and do not have to be prorated. The petitioner entered into fixed-unit-price, performance-based contracts under the requirements of 20 C.F.R. §629.38(e)(2)(iii).

A fixed-unit-price contract calls for a contractor to be paid a fixed price for performing the training or service required by the awarding agency. For every individual who successfully completes training or who is placed in a job, the contractor receives an agreed upon fixed-unit-price. In comparison, a cost reimbursement contract is an agreement by which an agency will pay a contractor the actual cost of training individuals. Payment is usually made after the submission of an invoice to the agency.

The risk to a contractor is greater in a fixed-unit-price contract. Indeed, federal regulations recognize that a fixed-unit-price contract "places upon the contractor maximum risk and full responsibility for all costs and

resulting profits or loss." 48 C.F.R. §16.202-1. If a contractor does not perform under a fixed-unit-price, performance-based contract, there can be no payment to the contractor. The contractor, therefore, runs the risk of losing money under a fixed-unit-price, performance-based contract. Payments to contractors under a cost reimbursement contract, however, are made despite performance. Contractors under fixed-unit-price, performance-based contracts, therefore, have a maximum incentive to avoid waste and to be as efficient as possible. Contractors who are successful in this regard generally will receive a profit.

The contracts at issue were entered into without USDOL guidance or notice of proper cost analysis. The ALJ correctly found that when awarding the contracts to NOCC and TTD, there was no requirement to perform a written cost analysis. (*See*, Appendix, p. 38a, n. 17.) Further, during the program years of 1986 and 1987, there was no requirement to perform a cost analysis. (*See*, Appendix, p. 46a, n. 20.) The requirements of a cost analysis, either written or otherwise, did not become effective until 1993, several years later. 20 C.F.R. §627-420(e) (1993).

Moreover, there was no guidance regarding record keeping at the time petitioners contracted with NOCC and TTD. Both the JTPA law (29 U.S.C. §1575(a)(1)) and JTPA regulations (29 C.F.R. §629.35(a)(2)) simply required that adequate records be maintained to show that the funds have not been spent unlawfully or used in violation of the restrictions on the use of such funds. During 1985-1987, when the contracts at issue were entered into,

USDOL provided no guidance as to what may be unlawful in the procurement of fixed-unit-price, performance-based contracts.

In fact, states and SDA's were left to operate without any guidance from USDOL concerning fixed-unit-price, performance-based contracts until 1989. 54 Fed. Reg. 10459 (1989). Even then, guidance came only *after* petitioner, the City of New Orleans, entered into the contracts in question. These types of contracts were, nevertheless, lawful when executed. The training offered by NOCC and TTD under the contracts was lawful. The duty to ensure that funds were not spent unlawfully belonged to the Governor. 29 U.S.C. §629.35. Nothing produced by USDOL suggested that the funds in question were spent in anything other than a lawful manner.

4. Subsequent Regulations Regarding Fixed-Unit Price Contracts

After Congress amended JTPA in 1992, USDOL promulgated additional regulations concerning procurement and fixed-unit-price contracting. Specifically, Congress required the Secretary of USDOL to establish minimum requirements to ensure that for states and SDAs:

> (C) Procurements shall include an appropriate analysis of the reasonableness of costs and prices;
>
> (D) Procurement shall not provide excess program income (for non-profit and governmental entities), and that appropriate factors shall be utilized in determining

> whether such income or profit is excessive such as:
>
> (i) The complexity of the work performed;
>
> (ii) The risk borne by the contractor; and
>
> (iii) Market conditions in the surrounding geographic areas.

29 U.S.C. §1574(a)(3)(C) and (D) (1992).

These amendments were effective July 1, 1993, more than *six years* after petitioner's execution of the contracts at issue herein. Furthermore, on September 2, 1994, USDOL promulgated 20 C.F.R. §627-420(e) requiring that, for all procurements, a cost analysis must be performed. 59 Fed. Reg. 45760 *et seq.* (1994). This rule was to be effective July 1, 1995.

Other amendments to JTPA that directly relate to the USDOL's analysis of the contracts issues herein are as follows:

> 29 U.S.C. §1574(a)(1) was amended to now include a requirement that records of all financial transactions be maintained. This directly relates to petitioner's belief that financial records for fixed-unit-price, performance-based contracts were not needed;
>
> 29 U.S.C. §1574(a)(3)(C) now requires as part of procurement, an analysis of the reasonableness of costs and price. No specific mention of a requirement of documentation showing a cost and price analysis was previously required;
>
> 29 U.S.C. §1574(a)(3)(D) now prohibits excess profit. No mention of profit, excess or otherwise, was previously mentioned in connection

with fixed-unit-price, performance-based contracts.

29 U.S.C. §1575(b)(3)(B) now requires that an entity being audited shall be notified as soon as practicable if the scope of an audit substantially changes. Had petitioner, City of New Orleans, been made aware of the expansion of the audit, documentation cited by the OIG as missing could have been provided.

Petitioner does not question the USDOL's authority to propose changes to JTPA rules and regulations. However, the petitioner strenuously objects to the retroactive application of these rule changes. Obviously, the USDOL perceived a need to enact amendments and make clarifications to JTPA that were not present in the original legislation. It is also obvious that the USDOL retroactively enforced these regulations on the City of New Orleans in its audit. The petitioners were sanctioned without the benefit of knowledge of the JTPA amendments and clarifications. Petitioners were substantially affected adversely due to the USDOL's imposition of standards not yet clarified or promulgated.

ARGUMENT

1. The Application Of A Cost Analysis To The Fixed-Unit-Price Contracts Was An Impermissible Policy Change And Violated Petitioner's Due Process Rights

By sanctioning petitioners for an alleged failure to consider costs prior to awarding contracts, the USDOL retroactively applied regulations concerning contracting

and procurement requirements. Retroactive administrative rules are not favored and will not be upheld absent an express statutory grant. *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 208, 109 S. Ct. 468, 471-472, 102 L.Ed.2d 493 (1988).

In *Bowen*, this Court held that as a general matter statutory grants of rule making authority do not encompass the power to promulgate retroactive rules unless that power is conveyed by express terms. There, this Court found that the Medicare Act's general grant of authority to the Secretary of Health and Human Services to promulgate cost-limit rules did not contain an express authorization for retroactive rule making. The absence of express authorization weighed heavily against the Secretary's position when the Secretary issued a cost-limit schedule that changed the method of calculating the "wage index," a factor used to reflect the salary levels of hospital employees in different parts of the country. Moreover, this Court found that the legislative history of the cost-limit provision indicates that Congress intended to forbid retroactive cost-limit rules. Accordingly, the Court determined that the Secretary did not have authority to promulgate and then enforce the retroactive cost-limit rules.

In this case, JTPA regulations allow rule promulgation, but permit prospective only application. 29 U.S.C. §1579(a). That statute states:

> All such rules and regulations shall be published in the Federal Registry at least 30 days before their effective date.

The USDOL's application and interpretation of procurement procedures were not in effect at the time of the contract, and sanctioning of petitioners for failure to abide by these procedures and interpretations was a violation of petitioner's due process right of notice of prohibited conduct.

Courts do not look with favor upon agencies that establish new standards to sanction or penalize parties. It has been held that agencies may not adjudicate new rules or interpretations where "some new liability is sought to be imposed on individuals for past actions which were taken in good faith reliance on . . . [agency] pronouncements" or where "fines or damages" are involved. *NLRB v. Bell Aerospace Co. Div. Of Textron, Inc.*, 416 U.S. 267, 295, 94 S. Ct. 1757, 1772, 40 L.Ed.2d 134 (1974); *United Gas Pipeline v. F.E.R.C.*, 597 F.2d 581, 588 (5th Cir. 1979), *cert. denied*, 445 U.S. 916 (1980). To uphold a sanction based on a new interpretation of a vague regulation was an abuse of the Secretary's authority. 20 C.F.R. §629.38(e)(2).

The USDOL was never comfortable with the scheme that turned vast responsibility over to the states, particularly regarding fixed-unit-price contracts. On November 18, 1987, the USDOL issued Training and Employment Guidance Letter ("TEGL") No. 3-87, which addressed concerns regarding fixed-unit-price, performance-based contracts under 20 C.F.R. §629.38(c)(2), including profits generated by those contracts. There, the USDOL stated that it planned to publish an official policy interpretation that, "when finalized, will be enforceable from an effective date forward." On March 11, 1988, the USDOL published a notice regarding "policy considerations in

administering JTPA regulations on fixed-unit-price, performance-based contracts" and requested public comment. 53 Fed. Reg. 7989, 7992 (1988). This circular noted that JTPA regulations did not adopt the OMB circulars regarding procurements and cost principles, but instead stated that it would "provide ample notice to the JTPA system prior to the effective date of any new policy interpretations on the use of fixed-unit-price, performance-based contracts." *Id.* at 7992. However, the USDOL began to enforce its new policy interpretations through audits such as the instant case, and never provided the promised notice.

On August 9, 1988, the USDOL proposed an official interpretation of the requirements for writing acceptable fixed-unit-price, performance-based contracts. 53 Fed. Reg. 29961 (1988). In this proposal, USDOL stated that it had decided to "rethink the application of 20 C.F.R. 629.38(e)(2) in terms of 1988 circumstances, not its original 1983 assumptions." *Id.* at 29965. In the basic principles identified by USDOL for the new policy interpretation, USDOL stated that:

> It is clear that technical assistance is needed for procurement in general and specifically for the new contract and policy. This may include assistance to states in setting rules.

Id. at 29965. Further, the USDOL included new specifications for acceptable contracts that stated that procurement must include "proposal review which verifies the reasonableness of proposed cost." *Id.* On March 13, 1989, USDOL published its official interpretation and made the effective date of the interpretation July 1, 1989. 54 Fed. Reg. 10459 (1989). Finally, in 1992, Congress enacted new

JTPA amendments affecting fixed unit price contracts, and directed the Secretary to prescribe minimum requirements concerning procurement. These proposals and amendments became effective July 1, 1993, years *after* NOCC and TTD completed performance and were paid under the contracts.

Though Congress did not enact new guidelines for fixed-unit-price contracts until 1993, the USDOL through the OIG began enforcing its proposed guidelines in audits as far back as program year 1985. For example, TEGL No. 3-87 states in pertinent part:

> 4. Course of Action
>
> a. *Notice to the JTPA system that the Department is studying training contracts.*
>
> The Department believes it advisable to promptly share our concerns about questionable contract situations and issues surrounding the application situations and issues surrounding the application of 20 C.F.R. 629.38(e)(2) within the JTPA system. Since the 1983 implementation of JTPA, certain applications of the fixed-unit-price regulation have raised questions, or have been the subject of investigation and cost disallowance. These were handled on a case-by-case basis, within the framework of the Act and present regulations. In some cases, however, questions concerning state and local interpretations were not completely resolved. **During PY 1985 and PY 1986, "problem contract" questions and specific examples were brought to the Department's attention through special investigations, compliance reviews, and inquiries.** These questions developed while more states and

> SDAs introduced performance-based contracting approaches, both to focus service deliverers on outcomes, and make use of the provisions of Section 629.38(e)(2) for charging 100 percent of the cost of training agreements to the training cost category. Broad questions concerning contracting practice and methods of negotiating and pricing JTPA subagreements have been noted. Therefore, the Employment and Training Administration (ETA) has begun to restudy this area of application of the JTPA regulations. This review has encompassed information on training contracts from the ongoing compliance oversight process, from audits, and from special investigation activities. 20 C.F.R. 629.38(e)(2). (Emphasis added).

Further evidence of the USDOL's predisposition against fixed-unit-price contracts came from the testimony of the USDOL's witness at the ALJ hearing, Mr. Donahue, who stated that "it made more sense to the Grant Officer to just add the service, the additional service to the cost reimbursement contract than to create a whole new contract." The auditor in charge, Marsha Secuskie, the Chief Auditor for the Department of Labor, also testified that they questioned the NOCC's contract because it was "irregular" to issue a fixed contract when there previously was a cost-based contract. Nevertheless, the USDOL's witnesses conceded that performance was not an issue when it reviewed performance-based fixed-unit-price contracts. Petitioners were sanctioned when the Grant Officer challenged funds paid to NOCC and TTD pursuant to two fixed-unit-price contracts, despite never receiving notice of the retroactive policy change.

No evidence was introduced showing that a misexpenditure of funds was "due to willful disregard of the

requirements of the Act, gross negligence, or failure to observe accepted standards of administration." 29 U.S.C. §1574(e). Petitioners exercised good faith when interpreting those sections of the Act at issue. As to the procurement of the contracts, 29 U.S.C. §1517 requires "consideration" of cost, not documentation of cost analysis. The petitioner proved it considered cost prior to entering into the contracts with NOCC and TTD.

As to the record-keeping requirements, there was no requirement that specific cost records are required in a fixed-unit-price, performance-based contract. Despite proving performance and showing that the funds were not used in violation of any restrictions in place at the time of contracting, the interpretation of 29 U.S.C. §1575 and 29 C.F.R. 629.35 adopted by the Governor, and applied in good faith by petitioner, was not accepted. To the extent that any ambiguities existed, local interpretations were encouraged under the JTPA by establishing policy-making responsibilities at the service delivery area.

In fact, the USDOL delegated policy-making authority to the states who in turn passed on this responsibility in many areas to the service delivery areas. Petitioners did not use federal funds in an unauthorized, or unlawful training program and they maintained records that showed successful performance. This was a justifiable effort by petitioners comply with the statute and statute interpretations.

Under JTPA, the Secretary is required to provide appropriate technical assistance to recipients and subrecipients. 29 U.S.C. §1734. No technical assistance or guidance was available on the treatment of fixed-unit-price, performance-based contracts until *after* the audit began. The USDOL adopted a policy which resulted in a repeal of a JTPA regulation dealing with these contracts. *See* 29 U.S.C. §1574(a) and 20 C.F.R. §627-420(e).

JTPA law now requires that the auditee be notified when practicable if the scope, objectives, or purposes of the audit change substantially during the audit. 29 U.S.C. §1575(C)(3)(B). Petitioners' first notice that the audit had been expanded occurred only after the Audit Report was issued. By this time, documents relating to the NOCC and TTD contracts were seized which further complicated any opportunity toward resolution.

At the time of passage of JTPA, Senate Report No. 97-469 (found at 96 Stat. 2636, *et seq.)* addressed the need for the legislation and the four basic principles essential for an effective job training program, including the insistence of federalism and insistence on performance. Congress intended that the JTPA would "recognize the role of the State in all local programs and end the excessive involvement of the federal government." 1982 U.S.C.C.A.N. 2637. The substitution of judgement by the USDOL in this matter as to the contracts at issue was a clear violation of the principle of federalism. The USDOL's decision to disallow costs in the NOCC contract was based partly on a belief that a cost-reimbursement contract would have been "preferable." Absent a showing of unlawfulness in a fixed-unit-price, performance-based

contract, costs should not have been disallowed. Performance, instead, should have been considered.

CONCLUSION

The USDOL's course of action and audit procedures show a deliberate attempt to impermissibly eliminate otherwise permissible fixed-unit-price contracts. The USDOL'S "special investigations, compliance reviews, and inquiries" were a clear circumvention of the legislative process. The USDOL's audit and retroactive application of guidelines that prohibit fixed-unit-price contracts was a violation of petitioner's due process rights under this Court's decision in *Bowen*. Accordingly, this Court should grant the Petitioner's Writ to decide this important issue and reverse the decision of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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RECORD EXCERPTS

1. Opinion of the Fifth Circuit Court of Appeals.. 1a

2. December 18, 1995 Decision from Secretary of United States Department of Labor denying Review of the Administrative Law Judge..... 18a

3. October 23, 1995 Decision and Order of the Administrative Law Judge (Dec. and Order).... 22a

STATE OF LOUISIANA, DEPARTMENT OF LABOR, Petitioner,

City of New Orleans, Intervenor,

v.

UNITED STATES DEPARTMENT OF LABOR, Respondent.

No. 96-60004.

United States Court of Appeals,
Fifth Circuit.

March 28, 1997.

Louisiana and City of New Orleans petitioned for review of final order of Department of Labor disallowing certain expenses allegedly incurred pursuant to Job Training Partnership Act (JTPA), and requiring state to repay such disallowed expenses to Department. The Court of Appeals, Jerry E. Smith, Circuit Judge, held that: (1) substantial evidence supported finding that job training program grant recipients failed to maintain accurate and reliable records under JTPA, and (2) substantial evidence supported finding that job service delivery area seeking federal grant funds for job training programs failed to comply with procurement procedures required to ensure that all costs allocated to grant were allowed JTPA.

Petition denied and affirmed.

Petition for Review of a Final Decision of the United States Department of Labor.

Before HIGGINBOTHAM, SMITH and BARKSDALE, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

Pursuant to 29 U.S.C. § 1578(a)(1), the State of Louisiana and the City of New Orleans petition for review of a final order of the U.S. Department of Labor ("USDOL") disallowing certain expenses allegedly incurred pursuant to the Job Training Partnership Act ("JTPA"), 29 U.S.C. § 1501 *et seq.*, and requiring the state to repay such disallowed expenses to the USDOL. Finding that petitioners are not entitled cavalierly to disregard the requirements of the JTPA, we deny the petition for review and affirm the order of the USDOL.

I.

In 1983, the state entered into an agreement with the Secretary of Labor to become a grant recipient under the JTPA.[1] Under this agreement, the state disbursed federal funds to several service delivery areas throughout the state, including New Orleans. Thereafter, the service delivery areas solicited grant proposals from service providers and selected subgrantees to receive the grant funds.[2] This case involves serious irregularities in the

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[1] Pursuant to this agreement, the state is required to comply with all rules and regulations governing the administration of JTPA grant funds. *See* 20 C.F.R. § 627.1 (1986).

[2] Although JTPA funds may be expended by a service delivery area or its service provider, the JTPA provides that the state shall be responsible for all funds disbursed under the grant and must hold subrecipients responsible for all funds received thereunder. *See* 29 U.S.C. § 1574(d)-(e); 20 C.F.R. § 629.44(d)(1) (1986).

administration of JTPA grant funds by the New Orleans Service Delivery Area ("NOSDA").[3]

In the NOSDA, classroom training programs were generally awarded under fixed-unit-price contracts, which demand successful performance as a prerequisite for payment.[4] Accordingly, the New Orleans Client Center ("NOCC") was awarded JTPA grant funds to conduct employment workshops for young adults during program year 1985, at a cost of $57 per successful participant. Likewise, Technical Training Designs, Inc. ("TTD"), was awarded JTPA grant funds to provide youth competency training in basic computer skills and remedial education during program years 1986 and 1987, at a cost of $1,400 per successful participant. NOCC and TTD successfully performed their obligations under the grant contracts,

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[3] The Orleans Private Industry Council ("OPIC") is formally responsible for the administration of the JTPA program in the NOSDA, but the New Orleans Office of Employment Training and Development ("OETD") manages the JTPA program on behalf of the OPIC and the city. Consequently, we refer to these administrative entities collectively as the NOSDA.

[4] Under a fixed-unit-price contract, compensation is based exclusively on successful performance of the contract. For every participant who successfully completes the job training program, the service provider receives a fixed fee. In comparison, a cost-reimbursement contract compensates service providers for the reasonable and necessary costs incurred pursuant to the job training program, without regard to students' success. *See* 20 C.F.R. § 629.38(e)(2) (1986); *see also* Job Training Partnership Act: Requirements for Acceptable Fixed Unit Price, Performance-Based Contracts, 54 Fed.Reg. 10,459 (1989) (stating the USDOL's official interpretation of fixed-unit-price contracts under the JTPA).

and each was paid according to the fixed-unit-price formula.[5]

In 1988, the USDOL initiated an audit of the New Orleans JTPA program, focusing on program years 1986-87.[6] After finding significant irregularities, the USDOL expanded the audit to cover program years 1985 through 1989. The audit disclosed serious deficiencies in procurement procedures, and auditors requested the financial records of service providers to quantify the costs of these deficiencies. Certain providers, however, refused voluntarily to disclose their financial records, forcing the USDOL to subpoena the records.[7]

The audit report, issued by the USDOL in 1991, questioned grant costs in excess of $6.4 million and recommended that the city be designated a high-risk subgrantee. All but $142,665 of these challenged costs were ultimately resolved in a separate proceeding, which is irrelevant to the instant case. The USDOL was unable, however, to resolve objections concerning the fixed-unit-price contract granted to the NOCC for program year 1985.

In 1992, the USDOL issued an initial determination in this case, disallowing the entire unresolved NOCC debt

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[5] NOCC received a payment of $142,665 under the fixed-unit-price contract, while TTD received payments of $798,630 and $280,420, respectively, under the two contracts.

[6] Under the JTPA, the program year begins on July 1 of the specified year and runs until June 30 of the succeeding year.

[7] The service providers whose contracts form the basis of this litigation – NOCC and TTD – were among those who refused to disclose their financial records.

of $142,665. Likewise, the USDOL disallowed total payments of $847,633 made to TTD under the fixed-unit-price contracts covering program years 1986 and 1987. Therefore, the initial determination disallowed a total of $990,298 in expenses incurred under the fixed-unit-price contracts between the NOSDA and NOCC and TTD.

After considering a response filed by the state that demonstrated that the audit report overstated total payments under the TTD contracts, the USDOL revised its initial determination, reducing the total disallowed costs allocated to TTD by $54,460. Likewise, the USDOL subsequently allowed additional costs of $41,223 under the NOCC contract. In the final determination, therefore, the total disallowance was reduced to $894,615.[8]

The state appealed this final determination to an administrative law judge ("ALJ"), who affirmed the final determination and ordered the state to repay the disallowed costs of $894,615.[9] The ALJ concluded that NOCC and TTD had failed to maintain accurate and reliable records as required by the JTPA[10] and that the NOSDA

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[8] This final disallowance represents the original disallowance of $990,298 reduced by the $54,460 allowance for the TTD contract and the $41,223 allowance for the NOCC contract. Of this final disallowance, $793,173 was allocated to the TTD contract, and $101,442 was allocated to the NOCC contract.

[9] The JTPA expressly provides that grant funds expended in violation of the act must be repaid to the United States, and authorizes the Secretary of Labor to impose sanctions for noncompliance with the statute. See 29 U.S.C. § 1574(d)-(e).

[10] The ALJ found that neither NOCC nor TTD had maintained records of expenditures, as required by the JTPA.

had violated statutory procurement procedures by failing to determine whether the grant proposals submitted by NOCC and TTD were fair and reasonable.[11] The state timely appealed to the Secretary of Labor, specifically identifying exceptions to the decision as required by 29 U.S.C. § 1576(b), but the Secretary refused to review the case. Therefore, the decision of the ALJ became the final decision of the Secretary. See 29 U.S.C. § 1576(b).

The state timely filed a petition for review, pursuant to 29 U.S.C. § 1578(a)(1). We then granted the city's motion to intervene in this petition for review. Having reviewed the Secretary's decision we deny the petition and affirm the Secretary's decision.

Indeed, the financial records were so incomplete that it was impossible for auditors to trace the grant funds.

[11] In reviewing grant proposals, the ALJ found that the NOSDA had not evaluated the cost-effectiveness of proposed programs, and grants were awarded without considering more efficient means of investing the grant funds. For example, the grant proposal submitted by NOCC left the section concerning cost information completely blank, and the NOSDA review committee failed to prepare an evaluation form on the NOCC proposal. Nevertheless, the NOCC proposal was accepted summarily, despite the fact that two members of the OPIC did not even have copies of the proposal.

Likewise, during the period in question, the NOSDA did not conduct surveys of comparable program costs to evaluate the cost-effectiveness of the grant proposals submitted by TTD. Nevertheless, despite these glaring deficiencies in the procurement procedures, the NOSDA accepted both the NOCC and TTD proposals.

II.

The Secretary disallowed the challenged costs on two grounds, concluding that the NOSDA had failed to comply with the procurement procedures specified under the JTPA and that subgrantees NOCC and TTD had failed to maintain accurate and reliable financial records as required by the JTPA.[12] We agree.

A.

A court entertaining a petition for review of a final decision issued by the Secretary of Labor, pursuant to 29 U.S.C. § 1578(a), may exercise only limited judicial review. "Review shall be limited to questions of law and the Secretary's findings of fact shall be conclusive if supported by substantial evidence." 29 U.S.C. § 1578(a)(3).

If the language of the JTPA is plain, we must enforce the unambiguously expressed intent of Congress. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43, 104 S.Ct. 2778, 2781-82, 81 L.Ed.2d 694 (1984). If the statute is ambiguous, however, we must defer to reasonable interpretations of the statute by the

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[12] In the final determination issued by the USDOL, the NOSDA was also charged with conflicts of interest in the administration of JTPA grant funds. The ALJ determined that a conflict of interest had existed but concluded that the JTPA did not prohibit such conflicts of interest during the period in question. *See* 29 U.S.C. § 1574(a)(3)(G) (1994). Therefore, the ALJ concluded that such conflicts of interest did not justify disallowance of the challenged expenses. We have no occasion to reconsider this decision.

USDOL, the agency charged with administering the JTPA. *Id.* at 843-44, 104 S.Ct. at 2781-83.

Likewise, our review of factual findings by the Secretary is tempered by respect for the expertise of the administrative agency. "Substantial evidence" is defined as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229, 59 S.Ct. 206, 217, 83 L.Ed. 126 (1938); *accord Pierce v. Underwood*, 487 U.S. 552, 564-65, 108 S.Ct. 2541, 2550, 101 L.Ed.2d 490 (1988). This standard contemplates something less than a preponderance of the evidence, and the mere fact that a different conclusion might be drawn from the evidence does not necessarily preclude a determination that an administrative decision was supported by substantial evidence. *Consolo v. Federal Maritime Comm'n*, 383 U.S. 607, 620, 86 S.Ct. 1018, 1026, 16 L.Ed.2d 131 (1966).

B.

First, the Secretary concluded that NOCC and TTD had failed to maintain accurate and reliable records, as required by the JTPA. During the period in question, the JTPA required grant recipients to keep financial records sufficient to permit the preparation of reports required by the act, and sufficient to permit the tracing of grant funds to insure that the funds were not spent unlawfully. *See* 29 U.S.C. § 1575(a)(1) (1982); 20 C.F.R. § 629.35(a) (1986).[13]

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[13] Although Congress has subsequently amended the JTPA to require specific reports from grant recipients, these requirements do not govern the instant case. *See* 29 U.S.C. § 1575 (1994).

The NOSDA, NOCC, and TTD disregarded this obligation with reckless abandon.

The Secretary's factual findings are supported by more than substantial evidence. In its audit report, upon which the Secretary relied in denying the challenged expenses, the USDOL found that the financial records maintained by NOCC and TTD were so irregular and unreliable that it was impossible to determine with any certainty whether JTPA grant funds had been allocated lawfully. The Secretary concluded that the NOSDA, acting through its subgrantees, had violated the JTPA by failing to maintain accurate and reliable financial records.

The state does not contest the accuracy of these factual findings but argues that it should be granted a special exemption from the JTPA's accounting requirements. Because fixed-unit-price contracts compensate the service provider only for successful performance, guaranteeing a flat fee for each participant who successfully graduates from the training program, the state avers that service providers have no obligation to maintain financial records under such fixed-unit-price contracts. This creative interpretation is unsupported by the plain language of the JTPA, the administrative regulations implementing the act, or previous judicial interpretations of the JTPA.

The plain language of 29 U.S.C. § 1575(a)(1) is unambiguous, requiring *all* recipients to maintain accurate and reliable records. Under such circumstances, when a statute is plain and unambiguous, we "give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 843, 104 S.Ct. at 2781; *accord United Servs. Auto. Ass'n v. Perry*, 102 F.3d 144, 146 (5th Cir.1996). The plain

language of the JTPA, and the administrative regulations promulgated thereunder, do not recognize a distinction between fixed-unit-price contracts and cost-reimbursement contracts. Consequently, neither do we.

Accordingly, JTPA grant recipients may not arrogate to themselves the authority to distinguish between fixed-unit-price contracts and cost-reimbursement contracts, nor may they disregard with impunity the accounting requirements explicitly prescribed by federal law. We decline the invitation to create an exemption from the JTPA by judicial fiat.[14]

The state cannot excuse its own gross negligence and that of its subrecipients by inventing exceptions from the accounting and record-keeping requirements of the JTPA. Substantial evidence supports the conclusion that Louisiana utterly failed to maintain accurate and reliable financial records, in violation of 29 U.S.C. § 1575(a)(1), and the Secretary correctly held that such nonfeasance constitutes a violation of the JTPA. Therefore, the Secretary properly denied the challenged expenses and ordered the state to repay the disallowed expenses. *See Montgomery County v. Department of Labor*, 757 F.2d 1510, 1513 (4th Cir.1985); *City of Oakland v. Donovan*, 703 F.2d 1104, 1107 (9th Cir.), *modified*, 707 F.2d 1013 (9th Cir.1983).[15]

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[14] Perhaps there are legitimate reasons to recognize a distinction between fixed-unit-price contracts and cost-reimbursement contracts for purposes of the JTPA, but these arguments are properly addressed to Congress, not to this court.

[15] Although *Montgomery County* and *City of Oakland* were decided under the Comprehensive Employment and Training Act ("CETA"), 29 U.S.C. §§ 801-999 (repealed 1982), that statute

> Record keeping is at the heart of the federal oversight and evaluation provisions of [JTPA] and its implementing regulations. Only by requiring documentation to support expenditures is the DOL able to verify that billions of federal grant dollars are spent for the purposes intended by Congress. Unless the burden of producing the required documentation is placed on recipients, federal grantees would be free to spend funds in whatever way they wished and obtain virtual immunity from wrongdoing by failing to keep required records. Neither [JTPA] nor the regulations permit such anomalous results.

Montgomery County, 757 F.2d at 1513. Consequently, we deny the petition and affirm the final decision of the Secretary disallowing the challenged expenses of $894,615 and requiring the state to repay these expenses from nonfederal funds.

C.

In addition, the Secretary disallowed the challenged expenses because the NOSDA failed to consider the cost-effectiveness of the proposals submitted by NOCC and TTD. During the period in question, the JTPA required service delivery areas requesting federal grant funds to adopt "job training plans," *see* 29 U.S.C. § 1514(a) (1982), which would include, *inter alia*, procedures for the selection of service providers that considered past performance in job training or related activities, fiscal

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was superseded by the JTPA. Therefore, the relevant provisions of CETA and the JTPA are effectively identical.

accountability, and ability to meet performance standards, *see* 29 U.S.C. § 1514(b)(5) (1982).

Furthermore, the JTPA specified that the "primary consideration" for selection of service providers should be the effectiveness of the service provider in delivering the necessary services, expressly citing the cost of the proposal as one variable in this calculus. *See* 29 U.S.C. § 1517(a) (1982).[16] Compliance with these procurement procedures was required to ensure that all costs allocated to the grant were allowed by the JTPA.[17] Finding that the NOSDA had cavalierly disregarded these procurement procedures, the Secretary concluded that the challenged expenses of $894,615 should be disallowed.[18]

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[16] During the period in question, JTPA procurement procedures were governed by 20 C.F.R. § 629.34 (1986). The state contends that the procurement procedures employed by the NOSDA were consistent with applicable state and local law, as required by 20 C.F.R. § 629.34. That provision, however, expressly incorporated the requirements of 29 U.S.C. § 1517, the federal statute upon which the Secretary relied in disallowing the challenged costs. Therefore, compliance with state and local law offers no shelter to the state.

[17] "Allowable costs" under the JTPA must be "necessary and reasonable for proper and efficient administration of the program" and must be allocable to the grant under the principles provided in the JTPA. 20 C.F.R. § 629.37(a) (1986). Costs incurred in violation of federal law are not allowable under the JTPA. *See* 20 C.F.R. § 629.37(c)(1) (1986).

[18] The state argues that the Secretary violated principles of due process by retroactively applying federal regulations concerning procurement procedures that were not enacted until years after the contracts in question were executed. *See, e.g.*, 29 U.S.C. § 1574(a)(3)(C)-(D) (1994); 20 C.F.R. § 627.420(e) (1996). This argument is without merit, as the Secretary based the final

This conclusion is supported by substantial evidence. First, the Secretary found no evidence to support the conclusion that the NOSDA had conducted a cost analysis of the grant proposals submitted by NOCC and TTD. To the contrary, the staff review committee failed to consider cost-effectiveness in preparing its evaluation of the NOCC proposal, and the proposal did not contain any budget or cost information as required by the JTPA. Instead, the NOCC proposal merely stated an estimated "slot cost," without providing any basis to determine whether the estimated cost was fair and reasonable.[19] Nevertheless, despite these omissions, and despite the fact that two voting members never even received a copy of the NOCC proposal, the OPIC summarily accepted the NOCC proposal.

Moreover, the Secretary determined that the fixed-unit-price contract awarded to NOCC for program year 1985 was not reasonable, because the NOCC was already being funded by a cost-reimbursement contract when the

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decision on statutes and regulations in effect at the time the contracts were executed. *See* 29 U.S.C. § 1517(a) (1982); 20 C.F.R. § 629.37(a) (1986). Consequently, the Secretary's final decision does not constitute a retroactive application of the JTPA.

[19] Moreover, the proposal submitted by NOCC concerned program year 1985, and NOCC performed its obligations under the contract during that program year. In defense of its procurement procedures, the NOSDA submitted a request for proposals issued by the recipient for program year 1986, and the corresponding grant proposals received for program year 1986. Because these proposals were not in direct competition with the NOCC proposal, however, the Secretary properly concluded that these documents were irrelevant to the determination of whether the NOCC proposal was fair and reasonable.

fixed-unit-price contract was awarded to NOCC. Indeed, the fixed-unit-price contract funded an employment workshop during the last month of the preceding cost-reimbursement contract, thereby duplicating efforts and duplicating program participants.

Under these suspect circumstances, auditors concluded that it was highly irregular to award a fixed-unit-price contract to a current contractor during the last month of a cost-reimbursement contract, without conducting any pre-award analysis of projected expenses. The Secretary concluded that these irregular procurement procedures violated the requirement that service delivery areas must consider cost-effectiveness and must determine whether grant proposals are fair and reasonable, and disallowed the challenged expenses.[20]

Likewise, the NOSDA awarded grant funds to TTD without conducting any analysis of cost-effectiveness. The grant proposal submitted by TTD for program year 1986 did not contain adequate budget information from which to determine whether the contract price was fair and reasonable; for program year 1987, the grant proposal submitted by TTD was never even provided to the auditors, who were unable to determine whether the contract price was fair and reasonable, or whether costs had even been considered by the NOSDA as required by

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[20] The sole evidence adduced by the state to rebut this factual conclusion – oblique testimony offered by three representatives of the city – was discredited by the Secretary. After weighing all the evidence in the record, the Secretary found this self-serving testimony unpersuasive. We agree.

the JTPA.[21] Therefore, the Secretary concluded that Louisiana had violated the JTPA by failing to consider the cost-effectiveness of the grant proposals submitted by TTD prior to awarding the contracts.

The state defends the procurement procedures adopted by the NOSDA, noting that subsequent surveys proved that the NOCC and TTD contracts were fair and reasonable. That is not the point. Once again, the state seeks to remedy the egregious defects in its procedures by retrospectively inventing exceptions to the JTPA. The plain language of the JTPA requires service delivery areas to consider cost-effectiveness in the decision to *award* grant funds, not to justify awards *after* those funds have been disbursed. *See* 29 U.S.C. § 1517(a) (1982). Substantial evidence supports the conclusion that the NOSDA failed to honor these procurement procedures, and the Secretary correctly disallowed the challenged expenses of $894,615.

The JTPA unambiguously mandates that service delivery areas disbursing federal grant funds must take an ounce of prevention, by determining whether grant proposals are fair and reasonable; the state cannot excuse its failure to do so merely by demonstrating that it has subsequently undertaken a pound of cure. Consequently, we deny the petition for review and affirm the final decision of the Secretary disallowing the challenged

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[21] Moreover, the auditors noted that TTD had subsequently agreed to provide identical training programs in program year 1988 for $150 less per participant than the fixed-unit-price contracts executed in program years 1986 and 1987.

expenses of $894,615 and requiring the state to repay these expenses from non-federal funds.

D.

Finally, Louisiana seeks to escape its obligations under the JTPA by raising a myriad of procedural objections to the USDOL audit, the decision of the ALJ, and the subsequent refusal of the Secretary to review the decision and waive repayment of the disallowed expenses. We have considered these objections and find them to be meritless.

III.

We conclude that the final decision of the Secretary is based on substantial evidence, and that the state and the NOSDA and its subgrantees cavalierly disregarded the accounting requirements and procurement procedures specified by the JTPA and the accompanying regulations. Federal grant recipients who are entrusted with public funds are bound to fulfill that public trust by discharging their duties in strict compliance with the requirements established by Congress. Accordingly, we emphasize that the procedural requirements of the JTPA are not merely hortatory ideals; they are obligatory duties. Grant recipients who, like the NOSDA and its subgrantees, fail to honor these procedural requirements, dishonor and disserve the public trust.[22]

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[22] It is ironic that today's result shifts the burden of these disallowed expenses to the state's taxpayers. We also recognize that our decision requires the city to assume responsibility for

The petition for review is DENIED, and the final decision of the Secretary of Labor is AFFIRMED.

$894,615 of disallowed expenses as a consequence of the procedural deficiencies in the grant process and the unprofessional accounting practices of its subgrantees. We express no opinion as to whether the city may seek indemnity for these expenses from its subgrantees.

U.S. Department of Labor Office of
Administrative Appeals
Washington, D.C. 20210 [SEAL]

DEC 18 1995 Rec'd JAN 3, 1996 RJR

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Re: *State of Louisiana, Department of Labor v. U. S. Department of Labor,*
Case No. 94-JTP-13

Dear Mr. Roux:

This refers to your communication of November 9, 1995, setting forth the State of Louisiana's and the City of New Orleans' exceptions to the October 23, 1995, decision of the Administrative Law Judge in *State of Louisiana, Department of Labor v. U.S. Department of Labor,* Case No. 94-JTP-13. This is to notify you that the Secretary has considered the State of Louisiana's exceptions but has not accepted this case for review.

Section 166(b) of the Job Training Partnership Act (JTPA), provides that –

> The decision of the administrative law judge shall constitute final action by the Secretary unless, within 20 days after receipt of the decision of the administrative law judge, a party dissatisfied with the decision or any part thereof has filed exceptions with the Secretary specifically identifying the procedure, fact, law, or policy to which exception is taken. . . .

> Thereafter the decision of the administrative law judge shall become the final decision of the Secretary unless the Secretary, within 30 days of such filing, has notified the parties that the case has been accepted for review.

29 U.S.C. § 1576(b) (1988). Rights of the parties to judicial review of final decisions in JTPA matters are indicated in Section 168(a)(1) of the JTPA statute, 29 U.S.C. § 1578(a)(1). The statute provides that the party seeking judicial review may obtain such review in the United States Court of Appeals having jurisdiction over the applicant by filing a review petition *within 30 days of such final order.* A copy of this letter is being sent to the other parties in this case.

Very truly yours,

/s/ David A. O'Brien
David A. O'Brien
Acting Director

CERTIFICATE OF SERVICE

Case Name: *State of Louisiana, Department of Labor v. U.S. Department of Labor,*

Case Nos.: 94-JTP-13

Document: 30 Day Letter

A copy of the above-referenced document was sent to the following persons on DEC 18 1995.

/s/ Tisa McRae

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Date: Oct 23 1995
Case No. 94-JTP-13

In the Matter of

STATE OF LOUISIANA
DEPARTMENT OF LABOR
Complainant

versus

U.S. DEPARTMENT OF LABOR
Respondent

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BEFORE: JAMES W. KERR, JR.
Administrative Law Judge

DECISION AND ORDER

This case arises under title II of the Job Training Partnership Act ("JTPA or the Act"), 29 U.S.C. §§ 1601-1605, 1631-1634 (1982), and its implementing regulations at 20 C.F.R. Parts 629-630 (1986-1988).[1] In accordance with a signed grant between Employment and Training Administration ("ETA") and the state of Louisiana ("Louisiana or the state"),[2] the grant program in question gave the state federal money to provide job training services for disadvantaged youths and adults. 20 C.F.R. 627.1. Louisiana received grant funds from the United States Department of Labor ("USDOL") and disbursed the funds to a subrecipient, New Orleans JTPA Service Delivery Area ("New Orleans"), who contracted with the New Orleans Client Center ("Client Center") and Technical Training Designs, Inc. ("Technical Training"), to provide job findings workshops, basic computer training, and remedial education for JTPA participants. (TR 19-20). In October of 1988, the Office of Inspector General ("Inspector General") audited New Orleans's JTPA programs. The Inspector General issued an audit

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[1] Since the disallowed costs in question here were incurred between *June 6, 1986 and October 14, 1988*, the 1982 version of JTPA applies to the period when the disallowed costs were incurred. 29 U.S.C. § 1501 *et seq.* However, amendments to the stature [sic] govern some of the subsequent procedural events and are cited accordingly.

[2] The agreement states that guidelines, interpretations, and definitions adopted by the governor of Louisiana shall be accepted by the Secretary as long as they are consistent with the Act and regulations. *See* 20 C.F.R. 627.1.

report on February 6, 1991, which questioned total grant costs of $6,434.235 [sic]. (RX 1).[3]

Out of the $6.4 million questioned in the audit report, all but $894,615, which was paid pursuant to fixed unit price contracts with Client Center and Technical Training, were resolved separately in an Administrative Law Judge Decision, Case No. 92-JTP-27. The matter was forwarded for resolution to the Employment and Training Administration. On January 5, 1994, the Grant Officer issued a Final Determination which disallowed costs of $894,615 and required Louisiana as the recipient of the funds from ETA to repay the funds.[4] On January 25, 1994, Louisiana appealed the Grant Officer's Final Determination to the Office of Administrative Law Judges. A hearing was held in this matter on July 7, 1994 in Baton Rouge, Louisiana. Complainant submitted three exhibits, and Respondent submitted one exhibit. This decision will be based on the evidence in the record.

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[3] The following abbreviations will be used in citations to the record: CTX – Court's Exhibit, CX – Complainant's Exhibit, RX – Respondent's Exhibit, and TR – Transcript of the Proceedings.

[4] The JTPA and its regulations provides that the recipient of the money, the state, is responsible for repaying the grant funds to ETA; thus, because Louisiana was the one who received the funds from ETA, it has to repay the funds if the Court finds that the funds are subject to federal debt collection. 29 U.S.C. § 1574(d).

ISSUES

(1) Whether the Grant Officer correctly disallowed the New Orleans's JTPA fixed unit price contract payments of $101,442 to the Client Center; and

(2) Whether the grant Officer correctly disallowed New Orleans's fixed unit price contract payments of $793,173 to Technical Training.

SUMMARY OF THE FACTS

Beginning in October of 1988, New Orleans's JTPA programs in 1985-1987 were audited by the USDOL's Office of Inspector General. (TR 125) (RX 1 p. 41). The Inspector General indicated that the audit objective was to identify potential problems [sic] areas dealing with contractor performance and procurement. (TR 194). After finding some problems, the auditors extended that audit period through June 30, 1990 without notifying New Orleans of the extension.[5] (TR 20, 126-27, 185). Thus, the

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[5] Martha Secuskie, who is an auditor for the United States Department of Labor, Office of Inspector General, testified that she was the auditor in charge of the New Orleans audit wherein she supervised the auditors, conducted the field work, and prepared the findings. (TR 174-175). She explained that New Orleans was not notified of the extended audit period and was not given an opportunity to review the draft audit report due to the emergency nature of the audit findings and the serious risk to the millions of JTPA dollars given to New Orleans. New Orleans was designated as a high risk subgrantee due to the discovered problems such as a inadequate procurement system, invalid placements of contractor performance, conflict of interest, and excessive cost. (TR 176-177, 185) (RX 1 p. 33, 41-42, 46). Further, she stated that the auditors were not bound by the

audit covered the period from January 1986, which is the second half of the 1985 program year, through June 1990, which in [sic] the 1989 program year.[6] (TR 20). On February 6, 1991, the Inspector General released its final report on the audit of New Orleans's JTPA programs to the ETA. (TR 78) (RX 1 p. 31-92). After receipt of the report, the ETA provided Louisiana and in this case the subrecipient, New Orleans, a copy of the report and directed Louisiana to resolve the audit with New Orleans and then submit an audit resolution report. On June 19, 1992, Louisiana responded to Findings C and D of the audit report. (TR 22-23) (RX 1 p. 121-183).

After reviewing Louisiana's response, the Grant Officer refused Louisiana's resolution report and issued an Initial Determination. (RX 1 p. 21-29). Louisiana was provided with a copy of the Initial Determination and given an opportunity to submit additional documentation and discuss the findings. (RX 1 p. 184-185). After receiving and reviewing additional documentation submitted by Louisiana as well as considering the prior information,[7]

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scope of the original audit period. Under the Inspector General's Act of 1978, she reasoned that the Office of the Inspector General had broad statutory authority "to prevent and detect fraud and abuse in . . . [federal] programs and operations." 5 U.S.C. app. § 2 (2)(B) (1982). When problems are discovered such as the conflict of interest and trouble contacting the OETD, she stated that the auditor can go beyond the scope of the audit without notification to New Orleans based on statutory authority. (TR 186, 199-200).

[6] The program years for the applicable sections of the JTPA run from July 1 to June 30. (RX 1 p. 90).

[7] Mr. Edward J. Donahue, Jr., who is a grants and contracts compliance specialist at Employment and Training

the Grant Officer issued a Final Determination on January 5, 1994, which disallowed payments of $894,615 in association with payments made under several fixed unit price contracts.[8] (RX 1 p. 9-19).

Finding C of the Final Determination dealt with a fixed unit price contract awarded to the Client Center to provide a workshop and pre-employment skills to about 2,400 participants and disallowed costs of $101,442. These costs were disallowed because of questionable procurement[9] and unnecessary and unreasonable costs allocated to the JTPA program. (RX 1 p. 13-15) (TR 30-32). Finding D of the Final Determination concerned two fixed unit price contracts awarded to Technical Training to provide youth competency training and disallowed costs of $894,615. (RX 1) (TR 20, 30). These costs were disallowed

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Administration, stated that he prepared the January 5, 1994 Final Determination which the Grant Officer signed. He explained that he considered all of documents submitted by Louisiana both prior to and after the Initial Determination. TR 17-18, 24).

[8] There are two types of contracts that are awarded under the JTPA program, the fixed unit price contract and the cost reimbursement contract. In a fixed unit price contract, the contractor receives a contractually agreed unit price for the number of participants who achieve the unit of training or placement in question. In a cost reimbursement contract, the contractor is paid according to its necessary and reasonable allocable costs for performing the required service. (TR 31).

[9] Subject to the provisions of Section 107 of the act, recipients and subrecipients shall administer procurement system that reflect applicable state and local laws, rules, and regulations as determined by the governor. 20 C.F.R. 629.34 (1984-1987).

due to flawed procurement procedures, conflicts of interest, and unnecessary and unreasonable costs allocated to the program. (RX 1 p. 13-19) (TR 44-47). The findings in the Final Determination were based on 20 C.F.R. 627.37 (1984-1988) which provides that allocable costs must be necessary and reasonable for the proper and efficient administration of the program. (RX 1 p. 13-19).

DISCUSSION

Under 20 C.F.R. §629.57 (1987), the United States Department of Labor shall have the burden of production to support the Secretary's decision. To this end, the Secretary shall prepare and file an administrative file in support of the decision. This means that USDOL must put forth sufficient evidence to establish a *prima facie* case in support of the alleged violations. This burden requires USDOL to produce relevant evidence "sufficient to enable a reasonable person to draw from it the inference sought to be established." McCormick, *Evidence*, 789-790 (2ed. 1972). Thereafter, the party, Louisiana, seeking to overturn the Secretary's decision shall have the burden of persuasion. Thus, USDOL must establish first that Louisiana violated JTPA regulations based on substantial evidence. Then, the burden shifts to Louisiana to show that it complied with the pertinent provisions of the JTPA.

I. The disallowed costs under the fixed unit price contract with the Client Center

1. Record keeping Requirements

With regard to Finding C of the Final Determination, the Grant Officer found that costs of $101,442 were unreasonable, unnecessary, and unallocable because the costs represented excess payments under the fixed unit price contract in the program year 1985. Specifically, the Grant Officer disallowed the costs because the Client Center failed to maintain reliable and adequate records to trace the level of expenditures under the contract. (RX 1 p. 13-15). The Grant Officer's finding is based on the audit report which stated that the Client Center's financial records were so unreliable and irregular that allocable costs under the fixed unit price contract could not be determined with any certainty. (RX 1 p. 54-58). The Grant Officer's finding is based on Section 165 (a) (1) of the JTPA (1982) which required that the recipients of the funds keep records that are sufficient to permit the tracing of funds to a level of expenditure to insure that the funds have not been spent unlawfully. 29 U.S.C. § 1575; 20 C.F.R. 629.35 (1984-1988).

In addition, the Grant Officer argued that the disallowance of the unrecorded costs were proper because Louisiana's failure to keep adequate records of grant costs constituted a recoverable expenditure of those costs as a matter of law. *See Montgomery County, Maryland v. Department of Labor,* 757 F.2d 1510, 1513 (4th Cir. 1985); *City of Oakland v. Donovan,* 703 F.2d 1104, 1107, *modified,* 707 F.2d 1013 (9th Cir. 1983). Although these cases involved contracts under CETA, the CETA provision in

the above cases[10] is very similar to the JTPA requirement at issue. Based on the above, the Court finds that USDOL has established a *prima facie* case based on substantial evidence that Louisiana through its subrecipient violated the JTPA and its regulations by not maintaining adequate control over its record keeping systems so that there were no accurate and reliable records to trace the level of expenditures of program funds.

Louisiana argued that the record requirement is not applicable under a fixed unit price contract. Although the contractor did not submit any documentation to support these costs such as a cost allocation plan, Mr. Kenneth Lane Christian, who is an auditor for Louisiana Department of Labor, stated that it was not the contractor's responsibility. He explained that the contractor only has to keep records regarding its performance of the services required in the fixed unit price contract, but the contractor does not have to keep records regarding its cost of doing business under a fixed unit price contract. However, Mr. Christian could not cite any statute or regulation that supported his opinion. He stated that if the regulation did not specifically state that the contractor had to specifically do something, then the contractor did not have to keep such records. (TR 136, 145-146, 169-170).

However, Section 165 of the JTPA requires that Louisiana, through its contractor, to keep accurate records so the expenditures can be traced. 29 U.S.C. § 1575 (1982). There is no distinction in the regulations between record

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[10] 29 U.S.C. §§ 801-999 (Supp. II 1978), *repealed by* the Job Training Partnership Act. 29 U.S.C. §§ 1501-1781 (1982).

requirements for a cost reimbursement contract and a fixed unit price contract.[11] Ms. Martha Secuskie, the head auditor for the Inspector General in the New Orleans audit, stated that there was nothing in the Act or its regulations that exempted fixed unit price contracts from maintaining financial records. Further, she reasoned that contractors have to keep financial records to show that they are in compliance with the regulation that requires them to have allocable, necessary, and reasonable costs under the program. (TR 180, 195, 198). Thus, the Court finds that there is a requirement under the JTPA requiring the state, through its contractor, to keep a record of expenditures. 29 U.S.C. § 1575.

In addition, although Louisiana admitted that there was no record of indirect costs, Louisiana argued that USDOL should have considered these costs by using a percentage of the direct costs. (TR 215-218). However, the burden is on Louisiana not USDOL to show that it kept records which established the level of expenditures; this burden was not met by Louisiana.[12] Finally, Louisiana

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[11] At the time of the contract period, 1985 to 1986, Part 629.38 (e) (2) was in effect which allowed for fixed unit price contracts. 20 C.F.R. 629.38 (e) (2) (1988). However, there was nothing in the regulation which exempted these contracts from the record keeping requirements of the Act. Part 629.38 is no longer part of the regulations. (TR 67).

[12] Although the scope of the audit was expanded, and Louisiana was not given an exit conference at the end of the audit, Louisiana was not prejudiced by these protective measures because the state was given ample opportunity to submit these records in response to the audit report. Initial determination and final determination. (RX 1 p. 12, 23-29, 121-185). Further, Louisiana had the chance for at least two and

argued that there were a number of costs incurred for the contract which were not considered such as the cost of the test instrument,[13] supplies, insurance, facility rent, staff costs, and lunches for participants. (RX 1 p. 122). However, Louisiana did not submit any documentation which recorded these expenses. (TR 33-35, 102-104, 109-110) (RX 1 p. 15). As discussed above, Louisiana failed to met [sic] it burden of keeping records of these expenditures.

Consequently, the Court finds that Louisiana failed to establish that it complied with the record keeping regulations under the JTPA. Because Louisiana violated the Act, the questioned cost of $101,442 in the Final Determination is subject to federal debt collection.

2. Conflicts of Interest

The Grant Officer also disallowed the costs because the initial contract was flawed by conflicts of interest and other irregularities in New Orleans' procurement of the initial contract. (RX 1 p. 13-15, 52-54). The auditors found that the Client Center and Technical Training were closely related companies that shared officers and many business

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a half years to examine the contractors' financial records but has not taken advantage of that opportunity. (RX 1 p. 13). The JTPA regulations require recipients to resolve audit findings concerning their subrecipients. 20 C.F.R. 629.42 (1991). Thus, the burden is on Louisiana to submit the records which establish the expenditures of program funds.

[13] Mr. Donahue indicated that the test instrument for this program had been paid by a prior fixed unit price contract. (TR 33-35).

transactions. The audit revealed that the Client Center and Technical Training had inter-company lease agreements that were less than arm's length. (RX 1 p. 50-51, 53) (TR 184-185). In fact, in view of the two companies' commingling of officers and transactions, the auditors concluded that the companies were not separate entities. (RX 1 p. 58). For example, Technical Training's 1984 JTPA contract proposal to New Orleans stated that Technical Training was doing business as the Client Center, and the Client Center was not incorporated as a separate company until the day after the contract started. (RX 1 p. 49, 53, 72). Based on these conflicts of interest, the auditors questioned the allocability of JTPA payments to the Client Center. (TR 48-50).

However, Mr. Donahue admitted that there was nothing in the JTPA or ETA issuances on conflict of interest during the periods in question.[14] (TR 48-50). Because there was nothing on conflict of interest in the JTPA, he stated that Louisiana had to follow state and local laws for procurement. 20 C.F.R. Part 629.34. Although there was no cite to any violation of any federal, state, or local law, Mr. Donahue stated that a conflict of interest existed based on the statement in the audit report. He explained that the conflict of interest findings were part of the whole findings in the Final Determination; specifically, he reasoned that the costs were disallowed because the costs

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[14] Subsequently, the JTPA was amended to indicate that conflict of interests were undesirable. (TR 95).

were not necessary, reasonable, and allocable to the contract, and the failure to demonstrate that a fair and reasonable price was negotiated based on a cost and price analysis. (TR 95-99, 209-215, 229-233).

Although there appears to be related party transactions, there is nothing in the Act of its regulations which prohibit such activity as long as the performance of the contract is satisfactory. The Grant Officer did not question performance under this contract. Due to the lack of any violation of any federal, state, or local law, USDOL has failed to establish a *prima facie* case of any violation of the JTPA under this allegation. Thus, this finding in the Final Determination must be reversed because it is not based on substantial evidence.

3. Procurement Procedures

The Grant Officer disallowed the costs under the Client Center contract as unnecessary costs because New Orleans failed to consider cost effectiveness when the contract was awarded. He explained that the excess payments under the fixed unit price contract could have been avoided if the award had been made as a modification to the existing cost reimbursement contract or as a new cost reimbursement contract.[15] (RX 1 p. 13-15). The auditors

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[15] In a fixed unit price contract, the contractor receives a contractually agreed unit price for the number of participants who achieve the unit of training or placement in question. In a cost reimbursement contract, the contractor is paid according to its necessary and reasonable allocable costs for performing the required service. (TR 31).

found that the Client Center's operations were already being funded by a cost reimbursement contract when the fixed unit price contract was awarded. The fixed unit price contract provided a workshop on job hunting for 2,700 youths for two weeks (June 6, to June 20, 1986) during the last month of the cost reimbursement contract. The cost reimbursement contract provided service to 2,400 youths, and on June 25, 1986, the contract was modified to provide service for 2,521 participants. The Client Center was already providing services of intake, eligibility determination, and assessment of clients. Thus, both contracts were provided instructions on pre-employment skills such as how to get ready for a job. Also, the Grant Officer felt that there was some overlapping of the same individuals. (RX 1 p. 13-15, 58, 72, 75 (TR 32-34, 41-42).

Since the participants covered by these two contracts appeared to have been largely the same people, the Grant Officer decided that the contract would have been more cost effective to add the two week workshop as a modification to the cost reimbursement contract rather than to create a new fixed unit price contract. (TR 32-33, 41-42). The auditors found that it was highly irregular to award a fixed unit price contract to a contractor in the last month of a cost reimbursement contract without any pre-award cost analysis of projected expenses. (RX 1 p. 75) (TR 181-182). Such a blind selection of a service provider violated the JTPA requirement to give "primary consideration" to, *inter alia*, the cost effectiveness of the provider's last delivery of comparable services. 29 U.S.C. § 1517(a).

Thus, the Grant Officer concluded that New Orleans did not consider the costs when awarding the service

provider contract. Under Section 107(a) of the JTPA, New Orleans should have considered the cost effectiveness of the contract in providing services to largely the same people.[16] (RX 1 p. 13-15) (TR 32-33, 41-42, 228-234). Although Mr. Donahue stated that there was nothing in the regulations to prohibit New Orleans from creating a new contract, and the regulations did not require that the contracts be awarded in the least costly manner, the Act requires that costs must be considered in awarding the contract to determine if the contract is based on a fair and reasonable price for fiscal accountability. (TR 36-44, 91-94) (RX 1 p. 13-15).

New Orleans procurement materials gave no indication that New Orleans did any pre-award cost analysis of the Client Center's proposal. (TR 33-34, 36-38). There was nothing in the evidence which indicated that the staff of the New Orleans service delivery area or the Private Industry Council (Council) considered the cost of the contract and determined that the Client Center's contract price was fair and reasonable. (TR 36-42). Specifically, New Orleans staff review committee left its evaluation

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[16] Specifically, Section 107(a) provides that "the primary consideration in services delivery area shall be effectiveness of the agency or organization in delivering comparable or related services based on demonstrated performances, in terms of the likelihood of meeting performance goals, *cost*, quality of training, and characteristics of participants . . . ". Section 107(a), 29 U.S.C. § 1517 (1982) (emphasis added). Further, "each job training plan shall contain . . . procedures, consistent with Section 107, for selecting service providers which take into account past performance in job training or related activities, *fiscal accountability*, and ability to meet performance standards." Section 104(b)(5), 29 U.S.C. § 1514 (1982) (emphasis added).

form on the Client Center blank. Mr. Donahue asserted that the Council was suppose to review and evaluate the proposal, but no evaluation was demonstrated on the evaluation sheet. The minutes of the Council meeting indicated that Mr. Bernard Alluli made a presentation in support of the Client Center's proposal, and that the Council summarily accepted the proposal even though two members complained that they did not have a copy of the proposal. (RX 1 p. 132-139) (TR 36-40).

In addition, Louisiana submitted a notice for request for proposal, the log of proposals received, and a copy of the Client Center's proposal. The Grant Officer determined that the proposal and the log of proposals for 1986 were for the wrong program year and were not in competition with the Client Center for services under the fixed unit price contract for 1985. Mr. Donahue stated that New Orleans did not follow proper procurement procedures because the Client Center's proposal was not responsive to the request for proposal for the 1986 program year and was not in competition with the other proposals for the 1986 program year. (RX 1 p. 13-15, 72, 124-140) (TR 35-40, 134).

Furthermore, the Client Center's proposal did not contain any budget or cost information as required under the procedures in the request for proposal. Instead, the Client Center's proposal simply stated an estimated slot cost without providing any basis for determining whether the price was fair and reasonable. Subsequently, New Orleans conducted a survey of professional testing technicians which established that Client Center's slot cost of $57 per participant was reasonable. The Grant Officer stated that the slot cost survey did not show that

the procurement of the Client Center's contract was proper because the survey was conducted after the award. Thus, the survey did not show that New Orleans considered the cost-effectiveness of the Client Center's proposal as required by the Act before awarding the contract. (RX 1 p. 13-15, 72, 124-161) (TR 35-44). Finally, although Louisiana alluded to a post award slot cost survey in its letters on June 19, 1992 and May 18, 1993, Louisiana did not submit the post award slot cost survey or any of its supporting data to the Grant Officer. (TR 26-51, 97-99, 112-113, 134-135) (RX 1 p. 15, 121-122).

Based on the above, the Court finds that USDOL has established a *prima facie* case based on substantial evidence of a JTPA violation. The above evidence shows that Louisiana violated Section 107(a) of the Act because it did not consider cost to determine if the contract was based on a fair and reasonable price when awarding the contract to the Client Center.

Thus, the burden shifts to Louisiana to show that it complied with Section 107(a) of the Act. 29 U.S.C. § 1517. The Court finds that Louisiana failed to establish that it complied with the regulation. Although Louisiana was not required to perform a written cost analysis[17] or engage in competitive procurement when awarding a contract, evidence must exist which established that New Orleans considered and determined that the contract was based on a fair and reasonable price. Louisiana submitted

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[17] The Act now requires that a cost analysis be performed effective July 1, 1993. 20 C.F.R. 627-420(e).

the testimony of Mr. A.C. Wilkinson[18] and Mr. Kenneth Christian[19] who stated that New Orleans complied with

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[18] Mr. Wilkinson is the assistant director for JTPA programs in Louisiana. As head of the audit resolution team, he reviewed Findings C and D of the audit report and the documentation submitted by New Orleans and then issued determinations on the findings with a team of people. (TR 101-102, 104). In response to the ETA, the audit resolution team concluded that documentation was sufficient to allow the cost. The response explained that the procurement was proper, and the costs were reasonable. (RX 1 p. 121) (TR 105). Thus, he opined that there were no disallowed costs as to Findings C and D that should be repaid to the USDOL. (TR 102-104).

The Court notes that Mr. Wilkinson had not reviewed copies of the Client Center's proposal; he only reviewed the Council minutes approving the contract and New Orleans survey of test technicians. (TR 110) (RX 1 p. 121). With regard to Finding D, Mr. Wilkinson stated that he only reviewed the survey of service providers and did not review New Orleans' evaluation of the cost reasonableness of the contract. He stated that he reviewed New Orleans' request for proposals and the submitted proposals. (TR 110-112). Thus, because he did not review all of the documents in the record, his opinion is not persuasive.

[19] Mr. Christian is an auditor for the Louisiana Department of Labor. He stated that his job duties required him to conduct financial and compliance audits of the JTPA funds. (TR 136). He stated that he reviewed the audit report of New Orleans which included Findings C and D and the documentation submitted by New Orleans. He also reviewed federal, state and local law. L.R.S. 39. (TR 139). He stated that he also reviewed the audit report and criticized the report; however, he stated that he did not review the working papers of the audit report. After reviewing the above, he allowed all the costs because the contracts were procured in accordance with federal, state, and local law. (TR 140-149, 156, 161-171) (CX 4).

the procurement procedures; however, they did not discuss whether New Orleans considered the cost effectiveness of the contract at the time the contract was awarded. Thus, their opinions are not persuasive on this issue. Further, Mr. David Thompson, who is in charge of the monitoring unit and audit resolution with the New Orleans Office of Employment, Training, and Development, stated that New Orleans performed a pre-award analysis of the reasonableness of the cost of Client Center's proposal during the verbal contract negotiations. (TR 134-135). His testimony alone is not sufficient to establish that New Orleans complied with Section 107(a) based on the other evidence regarding the Private Industry Council's meeting and the lack of discussion about the cost of the contract during that meeting.

Further, although Louisiana conducted a post award slot cost survey which showed that the cost of the contract with the Client Center was reasonable, this does not establish that cost was considered when the contract was awarded. Therefore, because Louisiana violated Section 107(a) of the Act by not considering cost during the negotiation process of the contract, the questioned costs of $101,442 must be repaid by Louisiana with non-federal funds to USDOL.

II. The disallowed costs under the fixed unit price contract with Technical Training

1. Record keeping Requirements

With regard to Finding D of the Final Determination, the Grant Officer disallowed the excess payments of

$793,173 made under the two fixed unit price contracts in 1986 and 1987 as unnecessary, unreasonable, and unallocable costs. Specifically, the Grant Officer determined that Technical Training's financial records were inadequate to trace the level of expenditures. The auditors had to subpoena the records, and the records did not include a general journal or adequate identification of contract expenses. (RX 1 p. 78-79). Consequently, the auditors had to reconstruct Technical Training's contract expenses and could find allocable costs of only $285,877. The disallowed costs represent the difference between the total payments under Technical Training's two fixed unit price contracts and the allocable expenses. (RX 1 p. 16-19, 78-83) (TR 47-48).

This disallowance is based on the JTPA record keeping requirements in Section 165(a)(1) and Part 629.35(a) which require that recipients of the funds keep records that are sufficient to permit the tracing of funds to a level of expenditure to insure that the funds have not been unlawfully spent. Section 165(a)(1), 29 U.S.C. § 1575 (1982); 20 C.F.R. 629.35 (1984). As discussed earlier, the Grant Officer's finding is proper because Louisiana's failure to maintain adequate records of grant funds constitutes a recoverable expenditure of those funds. *See Montgomery County, Maryland v. Department of Labor*, 757 F.2d 1510, 1513 (4th Cir. 1985); *City of Oakland v. Donovan*, 703 F.2d 1104, 1107, *modified*, 707 F.2d 1013 (9th Cir. 1983).

Consequently, based on the above, the Court finds that USDOL established a *prima facie* case based on substantial evidence that Louisiana through its subrecipient violated the record keeping requirements of the Act by

not maintaining adequate records to trace the level of expenditures of program funds.

Louisiana used the same arguments as discussed above that the record keeping requirements are not applicable to a fixed unit price contract. (TR 169-170). However, as the Court found above, Section 165(a)(1) is applicable to all contracts, and as a result, Louisiana was required to keep adequate records to allow the tracing of expenditures. (TR 180, 195, 198). Further, Louisiana argued that the Grant Officer did not consider indirect costs such as utility bills and rental space. (TR 169). However, the burden is on Louisiana to submit records or documents which exhibit the incurred expenses or provided a formula in a cost allocation plan for the auditors to determine the indirect costs. (TR 215-218). Thus, because Louisiana did not provide adequate documentation of these expenditures, the Grant Officer was correct in not considering these expenses. (TR 169, 183, 215-218) (RX 1 p. 18-19).

As Louisiana failed to establish that it complied with the record keeping requirements of the Act and its regulations, the Court finds that Louisiana violated Section 165(a)(1) of the Act. Consequently, the questioned costs of $793,127 in the Final Determination are subject to federal debt collection.

2. Conflicts of Interest

The Grant Officer also disallowed the costs because the costs were unreasonable and unnecessary due to conflicts of interest between Technical Training and the Client Center. (RX 1 p. 13-19). Technical Training and the

Client Center had a number of corporate officers in common. According to the contracts, final payment was contingent upon the participants' passing a competency test certified by the Client Center. The father of Technical Training's president was the Client Center official who certified the competency results attained. (RX 1 p. 16-19, 83) (TR 48-50). The Grant Officer based the disallowance of the disputed costs on Section 629.37(a) which provides:

> To be allowable, a cost must be necessary and reasonable for proper and efficient administration of the program, be allocable thereto under these principles, and, except as provided herein, not be a general expense required to carry out the overall responsibilities of the Governor's subrecipient. Costs charged to the program shall be consistent with those normally allowed in like circumstances in nonfederal sponsored activities and with applicable State and local law, rules or regulations as determined by the Governor.

20 C.F.R. 629.379(a).

In view of the two companies' intermingling of officers and transactions, the Grant Officer determined that it was questionable whether any fixed unit price contract payments to Technical Training were reasonable because performance may have been faulty. Under a fixed unit price contract, payment is only proper once satisfactory performance has occurred. (TR 31, 205). However, there was no indication in the record that satisfactory performance was not achieved according to the terms of the contract. (TR 146-147).

Further, as discussed above, Mr. Donahue admitted that there was no JTPA regulation in effect that addressed conflicts of interest during that time. Further, there was no allegation that Technical Training violated any state or local law on conflicts of interest. (TR 48-50, 95-99, 208-209, 232-233). Although there appears to be a conflict of interest, USDOL has not cited any violation of any federal, state, or local law which prohibits conflict of interest as long as performance is attained. As there was no question about the performance, the Court finds that USDOL failed to establish a *prima facie* case. Thus, the conflict of interest finding in the Final Determination must be reversed because it is not based on substantial evidence.

3. Procurement Procedures

Finally, the Grant Officer disallowed costs due to New Orleans' inadequate procurement procedures. The Grant Officer found that New Orleans awarded that contract to Technical Training without conducting a pre-award analysis of training costs. (RX 1 p. 16-19, 83) (TR 45-47). Further, the auditors found that Technical Training agreed to provide the same training in its program year 1988 contract for $150 less per participant than in the questioned contracts for program years 1986 and 1987. The Grant Officer's disallowance was based on Section 107(a) of the Act which requires service delivery area's to give primary consideration in selecting a service provider to demonstrated performance, cost effectiveness, quality of training, and characteristics of participants. Section 107(a), 29 U.S.C. § 1517 (1982). Further, Section 104(a) requires that the service delivery area take into account

fiscal accountability. Section 104(a), 29 U.S.C. § 1514 (1982). Thus, Section 107(a) of the Act required New Orleans to consider the cost effectiveness of the contract when awarding the contract. (TR 213, 228)

Louisiana submitted that request for proposal for year 1986 and the log of proposals received. (RX 1 p. 125-130). However, there was no evidence that New Orleans considered cost when awarding the 1986 contract. The proposal did not contain adequate budget information on which to consider cost effectiveness in which to establish a contract price. Further, New Orleans did not provide any materials for the program year 1987 contract. (RX 1 p. 18). Further, Mr. Donahue stated that the log showed that a number of proposals were submitted, but it failed to show what services were being performed under the proposal. Also, none of the proposals were submitted to the Grant Officer. Thus, Mr. Donahue stated that there was no way of determining if New Orleans considered cost and determined that the price of the contract was fair and reasonable. (TR 51-52).

Further, Louisiana performed a slot cost survey to indicate that the cost of the contract with Technical Training was reasonable. However, the survey was performed on June 10, 1992, which is after the contract was awarded. (TR 134). Thus, the survey does not indicate that New Orleans considered cost and determined that the contract price was fair and reasonable when the contract was awarded. (TR 48-52). Further, the service providers surveyed were not the other applicants in the 1986 and 1987 program competitions but rather the City's other service providers for those program years. (TR 131).

Based on the above, the Court finds that USDOL established a *prima facie* case based on substantial evidence that Louisiana through its subrecipient violated Section 107(a) of the Act because New Orleans failed to consider the cost effectiveness of the contract when the contract was awarded.

Louisiana failed to meet its burden that it complied with the regulation. As discussed above, Louisiana submitted the testimony of Mr. Thompson who stated that New Orleans considered the reasonableness of the cost in the verbal contract negotiations, and that there was no requirement that a cost analysis had to be in writing. (TR 134-135). Although the cost consideration did not have to be in writing,[20] his testimony is the only evidence that verbal communications existed with regard to cost consideration. This evidence alone does not establish that New Orleans considered the cost effectiveness of the contract because his testimony is outweighed by the majority of evidence discussed above. Furthermore, the testimony of Mr. Wilkinson and Mr. Christian that the contracts were properly procured is not persuasive because their opinions do not discuss whether New Orleans performed a pre-award cost analysis.

In addition, although New Orleans conducted a post award slot cost survey which showed that the cost of the contract with Technical Training was reasonable, this does not establish that cost was considered when the

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[20] Although during the program years of 1986 and 1987, there was no requirement to perform a cost analysis, the Act now requires that a cost analysis be performed effective July 1, 1993. 20 C.F.R. 627-420(e) (1993).

contract was awarded. Therefore, Louisiana failed to establish that it considered the cost effectiveness of the contract at the time it was awarded pursuant to Section 107(a) of the Act. As Louisiana through its subrecipient violated that Act, the questioned costs of $793,173 must be repaid by Louisiana to the USDOL with non-federal funds.

Conclusion

The Court finds that USDOL has established that the questioned costs of $101,442 under the fixed unit price contracts between New Orleans and the Client Center are subject to federal debt collection because Louisiana through its subrecipient failed to maintain adequate records and awarded contracts based on improper procurement procedures. Further, USDOL has established that the questioned costs of $793,173 under the fixed unit price contracts between New Orleans and Technical Training are also subject to federal debt collection because Louisiana failed to maintain adequate records as required by the Act and procured the contracts improperly. However, the Court reversed the findings of conflict of interest in the Final Determination because they were not based on substantial evidence.

ORDER

Accordingly, it is ORDERED that the State of Louisiana is responsible for repaying United States Department of Labor for grant funds in the amount of $894,615 with

non-federal funds for violating the Job Training Partnership Act based on the Final Determination of the Grant Officer.

Entered this 23rd day of October, 1995, at Metairie, Louisiana.

/s/ James W. Kerr, Jr.
JAMES W. KERR
Administrative Law Judge

JWK/td

SERVICE SHEET

Case Name: STATE OF LOUISIANA

Case No.: 94-JTP-13

Title of Document: DECISION AND ORDER

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No. 96-2031

In the Supreme Court of the United States

OCTOBER TERM, 1996

CITY OF NEW ORLEANS, PETITIONER

v.

UNITED STATES DEPARTMENT OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly sustained the Secretary of Labor's decision requiring the State of Louisiana to repay certain federal grant funds.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 108 F.3d 614. The decision of the Secretary of Labor denying discretionary review (Pet. App. 18a-21a) and the decision and order of the administrative law judge (Pet. App. 22a-49a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 28, 1997. The petition for a writ of certiorari was filed on June 25, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1983, the State of Louisiana entered into an agreement with the Secretary of Labor to become a grant recipient under the Job Training Partnership Act (JTPA), 29 U.S.C. 1501-1781 (1982).[1] Pet. App. 2a. The State disbursed federal grant funds to subgrantees within the State, including petitioner City of New Orleans, which then contracted with various service providers to provide job training to eligible individuals. *Ibid.*; see generally 29 U.S.C. 1501, 1511, 1514(b)(1), 1517 (1982). Under the JTPA, each state recipient is liable to repay to the United States any grant funds not expended in accordance with federal law, and subgrantees are responsible to the State for the grant funds they receive. 29 U.S.C. 1574(d) and (e) (1982); 20 C.F.R. 629.44(d)(1) (1986); see also Pet. App. 2a n.2.[2]

This case concerns three "fixed-unit-price" job training contracts awarded by petitioner: a $142,665 contract with the New Orleans Client Center (NOCC) in the 1985 program year, and contracts with Technical Training Designs, Inc. (TTD) for $798,630 and $280,420 during the 1986 and 1987 program years. Pet. App. 3a-4a & n.5. In such a contract, the service provider receives a fixed "unit price," agreed in ad-

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[1] References to the JTPA in this brief are generally to the original version of the Act, codified at 29 U.S.C. 1501 *et seq.* (1982), which was in effect during the period in which the disputed costs were incurred (June 1986 through October 1988). See Pet. App. 23a n.1.

[2] References to the JTPA regulations are generally to the 1986 edition of the Code of Federal Regulations, which was current during the first program year at issue. The applicable regulations were promulgated in 1983, 48 Fed. Reg. 11,076, and remained unchanged throughout the relevant period.

vance, for each individual who successfully completes training and obtains appropriate employment. See 20 C.F.R. 629.38(e)(2) (1986). This type of contract differs from a cost reimbursement contract, which compensates a service provider on the basis of the reasonable costs actually incurred in operating a training program, without regard to the success of its students. Pet. App. 3a n.4.

An audit of petitioner's JTPA program during the relevant period revealed both recordkeeping and procurement deficiencies. Based on that audit, the responsible Grant Officer at the Department of Labor found that NOCC and TTD (i) failed to keep financial records that were sufficient to ensure that federal funds had been spent lawfully, in violation of Section 165(a)(1) of JTPA, 29 U.S.C. 1575(a)(1) (1982), and 20 C.F.R. 629.35(a) (1986) (Pet. App. 29a, 40a-41a) and (ii) failed to consider cost-effectiveness when it entered into the three fixed unit price training contracts, in violation of Section 107(a) of JTPA, 29 U.S.C. 1517(a) (1982) (Pet. App. 35a-36a, 44a-45a). The Grant Officer disallowed total grant costs of $894,615, including $101,442 paid to NOCC and $793,173 paid to TTD. Pet. App. 5a & n.8, 26a-27a.

After a hearing, an administrative law judge (ALJ) upheld the Grant Officer's determination and ordered the State to repay the disallowed costs. Pet. App. 22a-49a. The ALJ rejected the State's argument that fixed unit price contracts were exempt from the JTPA's recordkeeping requirements, and he found that neither contractor had maintained adequate financial records. *Id.* at 29a-32a, 40a-42a) With respect to procurement procedures, the ALJ found no persuasive evidence that petitioner had considered cost before it awarded the three contracts at issue. *Id.* at

36a-40a, 44a-47a. The Secretary declined further review, and the ALJ's decision therefore became the Secretary's final decision under 29 U.S.C. 1576(b) (1988). Pet. App. 18a-19a.

2. The court of appeals affirmed. Pet. App. 1a-17a. After permitting petitioner to intervene in the State's petition for review of the Secretary's decision (see *id.* at 6a), the court held that petitioner, NOCC and TTD had disregarded their recordkeeping obligations with "reckless abandon." *Id.* at 9a. The court rejected the State's argument that the JTPA's recordkeeping requirements do not apply to fixed-unit-price contracts, and it found substantial evidence to support the Secretary's conclusion that the State had violated those requirements by "utterly fail[ing] to maintain accurate and reliable financial records." *Id.* at 9a-10a.

The court found substantial evidence to support the Secretary's conclusion that petitioner had violated the JTPA by awarding contracts to NOCC and TTD without any consideration of cost-effectiveness. Pet. App. 11a-16a. The court held that compliance with 29 U.S.C. 1514(b)(5) (1982), which required grant recipients to consider past performance, fiscal accountability, and ability to meet performance standards when selecting service providers, and 29 U.S.C. 1517(a) (1982), which specifically required consideration of "cost" in assessing the effectiveness of prospective service providers, was necessary to ensure that all costs allocated to a grant were allowable under the JTPA. Pet. App. 11a-12a & n.17.

The court of appeals specifically rejected the State's argument that "the Secretary violated principles of due process by retroactively applying federal regulations concerning procurement procedures that

were not enacted until years after the contracts in question were executed." Pet. App. 12a n.18 (citing 29 U.S.C. 1574(a)(3)(C) and (D) (1994) and 20 C.F.R. 627.420(e) (1996)). Because the Secretary "based [her] final decision on statutes and regulations in effect at the time the contracts were executed," her determination "[did] not constitute a retroactive application of the JTPA." Pet. App. 12a-13a n.18 (citing 29 U.S.C. 1517(a) (1982) and 20 C.F.R. 629.37(a) (1986)).

ARGUMENT

1. The recordkeeping provisions of the JTPA in effect during this period required recipients of grant funds to "keep records that are sufficient to permit the preparation of reports required by this chapter and to permit the tracing of funds to a level of expenditure adequate to insure that the funds have not been spent unlawfully." 29 U.S.C. 1575(a)(1) (1982). The Department of Labor's implementing regulations reiterated that requirement. 20 C.F.R. 629.35(a) (1986). Yet, the auditors who examined petitioner's contracts with NOCC and TTD were able to trace or reconstruct only a small portion of the expenditures relating to the three contracts in question. See Pet. App. 29a, 41a.[3] The payments so justified were allowed by the Secretary. *Ibid.* The remainder were disallowed because the State, petitioner, and the two contractors never documented how the money was spent, despite ample opportunities to do so in response to the audit report or to the Grant

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[3] The Secretary disallowed $101,442 of the $142,665 paid to NOCC and $793,173 of the $1,079,050 paid to TTD. See Pet. App. 4a n.5, 5a n.8.

Officer's initial and final determinations, or before the ALJ. See Pet. App. 4a-6a, 31a-32a & n.12.

Similarly, the statutory provision in effect throughout the relevant period concerning selection of service providers made clear that "[t]he primary consideration in selecting agencies or organizations to deliver services within a service delivery area shall be the effectiveness of the agency or organization in delivering comparable or related services based on demonstrated performance, in terms of the likelihood of meeting performance goals, *cost*, quality of training, and characteristics of participants." 29 U.S.C. 1517(a) (1982) (emphasis added); see also 29 U.S.C. 1514(b)(5) (1982) (requiring the adoption of "procedures, consistent with section 1517 of this title, for selecting service providers which take into account * * * fiscal accountability"). Although, as the ALJ acknowledged, the JTPA at the time did not require grantees "to perform a written cost analysis or engage in competitive procurement when awarding a contract," (footnote omitted) it did require some demonstration that petitioner had "considered and determined that the contract was based on a fair and reasonable price." Pet. App. 38a; *id.* at 46a. The ALJ found that the record before him did not substantiate even that minimal degree of consideration. *Id.* at 34a-40a, 44a-47a.[4]

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[4] The NOCC proposal, for example, did not contain any budget or cost information to support its proposed cost per trainee, and petitioner's review committee left its evaluation form on the NOCC proposal blank. Pet. App. 36a-37a. The 1986 TTD proposal likewise contained no budget information, and petitioner produced no documentation at all of its consideration of the 1987 TTD proposal. *Id.* at 45a. TTD pro-

After thoroughly reviewing the record (Pet. App. 2a-6a, 8a-15a), the court of appeals concluded (*id.* at 16a) that the Secretary's decision was based on substantial evidence, and indeed that petitioner and its contractors had "dishonor[ed] and disserve[d] the public trust" by "cavalierly disregard[ing] the accounting requirements and procurement procedures specified by the JTPA and the accompanying regulations." Petitioner's attempt to revisit those fact-bound determinations under superseded legal provisions (see Pet. 18-19) does not warrant further review.

2. Petitioner argues (Pet. 13-21) that the Secretary's decision in this case rested on impermissible retroactive application of new statutory or regulatory standards relating to contract procurement. See *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988). The court of appeals specifically rejected that argument. Pet. App. 12a n.18. As the court recognized (*ibid.*), "the Secretary based the final decision on statutes and regulations in effect at the time the contracts were executed," not on the more detailed requirements that were later adopted. See *id.* at 29a-31a & n.11, 38a & n.17, 41a-42a, 46a.[5] The court below is the only court of appeals that has addressed the application of the JTPA in analogous circumstances. See *Mississippi Dep't of Econ. & Community Dev.* v. *United States Dep't of Labor*, 90 F.3d 110 (5th Cir.

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vided the same training in 1988 for $150 less per trainee than in 1986 and 1987. *Id.* at 44a.

[5] The Secretary has never purported to adopt retroactive rules or policies under the JTPA. See, *e.g.*, *Jobs, Training & Servs., Inc.* v. *East Texas Council of Gov'ts*, 50 F.3d 1318, 1323 (5th Cir. 1995).

1996) (rejecting similar retroactivity arguments). In any event, petitioner does not argue that the JTPA recordkeeping provisions, on which the Secretary and the court of appeals also relied, were applied retroactively, and that ground alone is sufficient to support the decision below.

3. Finally, we note that on August 5, 1997, the State of Louisiana, which was a party below but which has not joined in petitioning this Court, transmitted to the Department a check in the amount of $894,615, "presented in satisfaction of the judgment" below. The transmittal letter notes that "[t]he enclosed payment * * * will bring a close to" this case. Even if we assume that petitioner, which intervened in the court below (Pet. App. 6a), retains standing to litigate this matter on its own behalf, the evident decision by the State—which is the only party with whom the Secretary ever entered into an agreement with respect to JTPA funds (see *id.* at 2a)—not to pursue the matter argues persuasively against the need for review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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